

Before the
Federal Communications Commission
Washington, D.C. 20554

In the matter of IP-Enabled Services

WC Docket No. 04-36

In the Matter of Vonage Holding Corporation
Petition for Declaratory Ruling Concerning an
Order of the Minnesota Public Utilities
Commission

WC Docket No. 03-211

LATE-FILED COMMENTS
BY STATE MEMBERS OF SEPARATIONS JOINT BOARD

A. Summary

The Commission is widely reported to be considering, in the above-captioned proceedings, a decision to declare IP-enabled services to be interstate services and not subject to state jurisdiction. The State Members of the Separations Joint Board (“State Members”) file these comments to reiterate and expand upon our previous observation that any such decision will significantly affect the jurisdictional separation of common carrier property and expenses between interstate and intrastate operations. Therefore, consistent with section 410(c) of the Act, the Commission should make a referral to the Joint Board before acting.¹

¹ 47 U.S.C. § 410(c) requires the Commission to refer to the Joint Board any matter instituted pursuant to a Notice of Proposed Rulemaking regarding the jurisdictional

The State Members would like a full opportunity to discuss with our federal colleagues the inevitable effect of preemption on separations and therefore on state telecommunications rates. Accordingly, to ensure that the Commission has an opportunity to consider the possible implications of such preemptive action on the jurisdictional separations process, the State Members of the Separations Joint Board submit these comments. They address the likely effects of federal preemption of all IP-enabled services, including Voice over Internet Protocol communications (“VoIP”).

The State Members conclude that federal preemption of VoIP traffic would have significant effects on jurisdictional separations and also on the ability of states to recover costs separated to the intrastate jurisdiction through the existing separations process. In summary, preemption would exacerbate the tendency of VoIP traffic to impose costs on the state jurisdiction, but with little or no revenue; and it could prevent states from collecting a reasonable contribution to joint and common costs from VoIP traffic. In addition, federal preemption would exacerbate some existing problems relating to DSL lines. Finally, federal preemption could require ending the freeze immediately or it could complicate consideration of whether or how to end the separations freeze in 2006.

We recommend a number of steps below. These include issuing a Notice of Proposed Rulemaking (“NPRM”) on possible changes to the frozen separations factors due to preemption, possible changes due to increasing sales of DSL, and the collection of data relating to the end of the freeze.

separation of common carrier property and expenses between interstate and intrastate operations.

B. Request To File Comments

State Members respectfully request that the Commission authorize, within the meaning of Section 1.415(d) of its rules, the following out-of-time comments ("Comments") in the above captioned proceedings addressing separations issues raised by possible FCC action.² We ask the Commission to grant any waivers and/or authorizations that may be necessary to allow this filing.

State Members are making this filing because they have recently seen press statements that the FCC might be considering segregating jurisdictional issues from the generic IP rulemaking for early action. The subject matter at issue in this proceeding is of significant interest to the State Members, given its impact on the Separations process and ultimately on state rates. No other participant's comments can adequately represent the viewpoint of the State members, and we respectfully suggest that this viewpoint (and the need for a recommendation and referral of the relevant issues) is necessary to fully illuminate the issues raised by the FCC's proposal and develop a complete record upon which to base a decision. Hence, granting the requested authorization and/or waivers will serve the public interest.

No other participant will be prejudiced by allowing this late filing as most were logically expecting the FCC to act comprehensively in the generic IP rulemaking on this and related issues; and any who are concerned can still raise those concerns via an *ex parte* filing.

² Section 1.415(d) of the Commission's Rules states that "[n]o additional...", i.e., out-of-time, "...comments may be filed unless specifically requested or authorized by the Commission." See also, Sections 1.41, 1.44 of the Commission's Rules of Practice and Procedure

Alternatively, the State Members request that these Comments be accepted as written *ex parte* communications within the meaning of Section 1.419(b) and 1.1206 of the Commission's regulations.³

C. Separations Background

As the Supreme Court recognized in 1930, procedures for the separation of intrastate and interstate property and expenses are necessary for the appropriate recognition of authority between the interstate and intrastate jurisdictions.⁴ For the states, jurisdictionally separated costs are important because they define the state's constitutional obligation to avoid an uncompensated taking of utility property.

Our dual system of regulating telecommunications has worked reasonably well because both state and federal regulators have cooperated in trying to align jurisdiction, revenues, and costs. When a service is interstate, revenues from that service are recorded as interstate. Separations then seeks to assign with reasonable accuracy costs to the same jurisdiction in which revenues are recorded. Those costs include all directly incurred costs, plus a share of joint and common cost.

This is not to suggest that separations results are or ever were exactly correct. The result must, however, be reasonable. Moreover, the 1996 Act requires that services

³ Subject to certain conditions, a person may file "informal" *ex parte* comments after the deadline for reply comments. See 47 C.F.R. Section 1.419(b), which states that "[i]nformal comments filed after close of the reply comment period...should be labeled "ex parte" pursuant to section 1.12066(a) of this Chapter."

⁴ *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 148 (1930).

“included in the definition of universal service” cannot bear any more than a “reasonable share of the joint and common costs of facilities used to provide those services.”⁵

Separations rules have a significant effect on state rates. Many states still set those rates using a traditional “cost of service analysis” in which rates are set so that expected revenues equal the costs assigned to the state by separations. In these states, separations results have a direct effect on local rates. Other states use intrastate-separated costs as an element in their state universal service fund calculations.

Separations rules also affect the interstate jurisdiction. Many local exchange carriers remain under “rate of return” regulation as “cost” companies. Separated costs of these companies still affect the rates charged by these companies for interstate services.

Separations factors have been frozen since 2001 and will remain so until 2006. In its 2001 order adopting the freeze,⁶ the Commission made several commitments to the states. Because of new technologies and the emergence of local exchange service competition, the Joint Board had previously recommended that during the freeze the Joint Board and the Commission would continue to work on four separations issues: 1) unbundled network elements (UNEs); 2) digital subscriber line (DSL) services; 3) private lines; and 4) Internet traffic.⁷ In its Freeze Order, the Commission agreed:

that the comprehensive review of the separations process must continue during the freeze, and we thus commit to working with the Joint Board on a continuing basis during the freeze. As part of that continuing effort towards

⁵ See 47 U.S.C. § 254(k).

⁶ *Jurisdictional Separations Reform And Referral To The Federal-State Joint Board*, CC Docket No. 80-286, “Report and Order,” FCC 01-162 (rel. May 22, 2001) (“Freeze Order”).

⁷ *Id.*, para. 31.

comprehensive reform, we commit to working with the Joint Board to begin to address the four specified issues during the freeze.⁸

In another part of the Freeze Order, the Commission reiterated its commitment to “working with the Joint Board on a continuing basis to address the impact of the Internet and the growth in local minutes during the interim freeze.”⁹

D. Preemption Generally

Preemption of VoIP would reclassify what formerly were state services into interstate services. This can affect separations in two ways.

First, preemption would likely require changes to cost separations. Depending on its scope, preemption would likely require reexamination of some of the factors used to separate costs. The most financially significant separations factor is the basic “25-75” factor that is used to separate the costs of subscriber common lines (“Category 1.3”) and circuit equipment. This factor has been fully in place since 1993, and it was prescribed in 1987 at a time when interstate traffic was a mere 13 percent of total traffic.¹⁰

Other costs, such as switching, are separated by measured network usage, recorded as usage “factors.” Normally, a preemptive reclassification would change the identity of traffic, and therefore the results of traffic measurement, and the resulting usage-sensitive separation factors. Under the freeze, however, the factors are frozen until 2006.

⁸ *Id.*, para. 33.

⁹ *Id.*, para. 42.

¹⁰ Universal Service Monitoring Report, 2003, Table 8.3 (Dial Equipment Minutes Summary).

Second, preemption affects the classification of revenue. Historically, revenue accounting has been straightforward. Services tariffed at the FCC produced interstate revenue, and services tariffed at the state commissions produced intrastate revenue. Because interstate services produce interstate revenue, reclassification normally increases interstate revenue and decreases state revenue. To avoid raising local exchange rates, it could be necessary to similarly transfer the corresponding costs.

E. Separations, the Internet and the Freeze

The effect of the Internet on separations is not a new issue. This Joint Board recommended a separations freeze in July of 2000. At that time, the Commission was considering whether to declare Internet traffic to be interstate. The Joint Board recommended that, should such a declaration be made, a small adjustment should also be made to the existing Dial Equipment Minute (“DEM”) factors. The Joint Board suggested a “default estimate” that would have frozen the local DEM at 95% of the current year level. In other words, the Joint Board recommended that, at the outset of the freeze, the local DEM level for the base year be reduced by 5%, and that 5% would be shifted to interstate DEM, and the adjusted levels would be frozen.¹¹ The four state commissioners clarified their understanding of the recommendation by stating that they endorsed a freeze of the local DEM factor at *no more* than 95 percent of the current year level, unless a different conclusion was warranted by the record.¹² The recommended

¹¹ *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, Recommended Decision*, FCC 00J-2, released July 21, 2000 (“Freeze RD”), para. 29.

¹² *Id.* Joint Separate Statement of Chairman Thomas L. Welch, Commissioner Joan H. Smith, Commissioner Diane Munns, and Commissioner Joseph P. Mettner.

decision also recommended that four issues, including Internet traffic and DSL, “must be addressed by the Joint Board and the Commission in the near future as a result of the emergence of new technologies and local exchange service competition.”¹³

When the Commission adopted a freeze, it rejected the Joint Board’s recommendation, finding that it lacked “reliable data upon which to set the amount of any local DEM factor reduction that may be warranted.”¹⁴ Although commenters had estimated the percentage of intrastate traffic that represents Internet traffic to range from 3.1% to 71.5%, the Commission asserted that no party had “provided concrete evidence demonstrating rate increases or other actions directly attributable to increased Internet usage.”¹⁵

Furthermore, the Commission noted that it had directed carriers to treat the traffic-sensitive local switching costs that ISPs incur through their connections to LEC end-offices as intrastate for separations purposes, thereby avoiding cost-revenue mismatches.¹⁶

This was a curious conclusion in several respects. First, it assumed that Internet traffic did not generate any non-traffic-sensitive costs. Second, it assumed that the Commission could direct that an interstate service would be sold from state tariffs and the revenues assigned to state accounts. Third, it assumed that revenues collected in this manner would match the costs of the service.

¹³ *Id.*, para. 27.

¹⁴ *Freeze Order*, para 40.

¹⁵ *Id.*, para. 38.

¹⁶ *Id.*, para. 39.

As noted above, the Commission “commit[ted] in the Freeze Order to working with the Joint Board on a continuing basis to address the impact of the Internet and the growth in local minutes during the interim freeze.”¹⁷ Unfortunately, this question has not been addressed in any substantial way since the freeze was imposed.

This Joint Board is currently evaluating whether to recommend continuation of the current freeze on separations factors beyond its current sunset date of 2006. Under the freeze, regulated companies are still using separations factors that were calculated based on operations in 2000.

In the *MCI* case, the courts established that an interim freeze of the separations process was permissible while considering separations reform. Inaccuracy in separations factors is permissible, however, only as long as it is (a) temporary and (b) within reasonable bounds.¹⁸

In deciding whether to recommend continuation of the freeze, the broadest question before the Joint Board is whether the existing factors still produce a fair allocation of cost, particularly given new patterns in revenue generation. To reach a conclusion, the Joint Board must consider whether the factors have become obsolete by changing jurisdictional rules or by changing network structure or usage. We also must consider what would happen if the freeze were to expire by its own terms, and traffic measurement to recommence.

Network usage is changing, and the frozen factors are inevitably becoming less accurate measures of actual network usage. This suggests a need to end the freeze. On

¹⁷ *Id.*, para. 42.

¹⁸ *MCI Telecommunications Corp. v. FCC*, 750 F.2d 135, 141 (D.C. Cir. 1984).

the other hand, VoIP usage is making switched network usage measurements increasingly unreliable. This suggests a need for another method of separating costs.

The State Members believe that the decisions being considered in several matters before the Commission would cause the frozen separations factors to become so inaccurate as to violate the *MCI* standard. If, for example, the Commission were to make a decision that many intrastate calls are actually interstate, the existing separations freeze may become so inaccurate that it cannot be sustained without substantial modification, if at all. That problem would make the use of existing frozen factors unlawful because those decisions would exacerbate existing revenue-cost mismatches.

F. Separations, VoIP and Traffic Usage

In 2000, Internet usage was primarily for data, particularly transmission of Web pages. The effects on the switched network were indirect and mixed. There were even some positive financial effects, such as added line sales, that partially offset incremental costs. Now, however, several companies are offering VoIP, and many of these calls are originating or terminating on the switched network. VoIP providers now claim hundreds of thousands of customers. Millions of customers are forecast, and several large switched carriers are planning to convert some or all of their systems to IP format. With this VoIP growth, the impact on the switched network has become more direct, and its character has changed, as explained below.

Some forms of VoIP communication have no direct effect on separations or state rates. Broadband-to-broadband communications, even voice services such as those considered recently in the *Free World Dialup* decision, may depress usage on the

switched network, but they do not interact with that network. These indirect effects give us no reason to suggest any change to separations procedures.

If other forms of VoIP are declared to be interstate, however, we foresee significant effects on separations and on state ratemaking. When VoIP traffic uses the switched network for origination, termination or transiting, it imposes costs on LECs, and it may create revenues for LECs. However, its jurisdictional nature is difficult or impossible to measure. As explained below, this conclusion applies both to traffic originated by VoIP phones and traffic terminated on VoIP phones.

1. VoIP-Originated / Switched-Terminated

Switched interexchange carriers (“IXCs”) are required to identify the jurisdictional nature of their traffic and to pay compensation to other carriers accordingly. For example, when an IXC carries a call between two customers in different states, the IXC classifies the call as interstate, and that information is conveyed throughout the network. The terminating carrier can then charge the IXC the jurisdictionally appropriate rates, and the terminating carrier’s network can properly record the nature of its own traffic.

VoIP traffic does not follow these rules. Most state and federal regulators have allowed VoIP carriers to terminate traffic without declaring its jurisdictional nature and without paying traditional jurisdictionally defined charges. As a result, the nature of VoIP traffic is often unascertainable. With VoIP, any of three kinds of calls (interstate-toll, intrastate-toll and local) can appear on a terminating carrier’s network in any form. For example, a coast-to-coast VoIP call can appear on the switched network as a local call. While this call appears “local,” it is really “interstate” under current law. The result

is three possible methods to terminate each of the three kinds of calls. Of the nine possible combinations, three are matched and six are mismatched. As a result, LEC traffic measurements of terminating traffic become unreliable to the extent that they include VoIP traffic.

2. Switched-Originated / VoIP-Terminated

When a call is generated on the switched network, the originating carrier classifies the call based on the NPA and NXX of the called party. If the called party is in another state, usually the originating carrier will classify the call as interstate, and the minutes of use will be so recorded.

VoIP telephones, however, are portable. They require a broadband Internet port, but that port can be physically located anywhere in the world. For this reason, using the classical NPA and NXX method of determining jurisdiction is unreliable when a switched call terminates on a VoIP phone.

As a result, LEC traffic measurements of originating traffic are unreliable to the extent that they include VoIP traffic.

3. Preemption and the Separations Factors

Measurement errors, to the extent they arise after 2000, may not now be causing any harm since separations factors are currently frozen.¹⁹ They might, however, have a

¹⁹ Revenue-cost mismatches arising from jurisdictional reclassifications are considered in the next section.

substantial effect if the freeze is allowed to expire, and that might be one reason to extend the freeze.²⁰

If VoIP is preemptively an interstate service, however, the freeze issue changes. Measurement problems would be compounded. A call that is today an intrastate toll call, for example, might be terminated by a VoIP carrier as intrastate-local; yet it would still be recorded as intrastate and would cause no jurisdictional errors. With preemption, however, those calls would be interstate, and a record of the call as a local call would be inaccurate.

G. Separations, VoIP and Costs

1. Direct Assignment

Some carrier equipment today is directly assigned. For example, private line equipment is assigned entirely either to the interstate or the intrastate jurisdiction. Most telephone plant, however, is commonly used for both interstate and intrastate services; and this equipment is separated using either fixed factors or usage factors.

If the Commission were to declare VoIP interstate, that decision would presumably apply to all carriers, including LECs. It seems likely that some joint and common LEC equipment would become single-purpose equipment. Such VoIP-dedicated equipment might include Internet routers, but also (depending on the telephone company's choice of technology) much or all of its switching, transport and loop plant.

²⁰ Errors also can be expected to affect rate designs in at least one state that did not freeze separations for state ratemaking purposes.

More detailed special assignment rules may be needed reflecting varying levels of VoIP technology implementation.

In a full conversion of a LEC's system to VoIP, current rules may require all telephone plant to be directly assigned to interstate. This would leave the intrastate jurisdiction without any plant or expenses, and that could lead to elimination of and need for any state rates, including local exchange rates.

Carriers can be expected to oppose elimination of local exchange rates, particularly if the Commission does not provide a replacement revenue source. If the direct assignment rules are not clarified, carriers could be inadvertently deterred from converting their networks to IP networks.

2. Current Mismatches For Traffic Terminating As Local Calls

We noted above that VoIP produces six kinds of jurisdictional mismatches. We consider here the cost implications of two such mismatches.

a) The Interstate Toll Call Terminated as Local

A VoIP carrier can transport a call between end users in different states, but terminate the call from a retail business line.²¹ The VoIP carrier uses that line for termination, using it as a kind of terminating trunk to the end user. Usage on these lines is not likely to be similar to typical business lines. The local exchange carrier records only a local call from the VoIP carrier's business line to the terminating end user.

²¹ This is a frequent occurrence because in many areas it is a least-cost termination method for VoIP calls. VoIP carriers may also use Centrex lines for the same purpose.

These calls can create incremental costs in both jurisdictions. Incremental costs could include additional concentrator equipment and more line cards in the switch as the local network's usage characteristics change.²² Absent any changes to the rules, any incremental investment would be separated using the existing fixed separations factor for common line and circuit equipment: 75 percent of the incremental cost would fall on the intrastate jurisdiction, and 25 percent on interstate.

Incremental costs could also include larger switches. If, as is often true, the local calling area comprises more than one exchange, more interoffice trunks may also be needed. These incremental costs would be separated by the frozen factors. At least for the larger companies, about 70 percent of the incremental cost would fall on the intrastate jurisdiction and 30 percent on interstate.²³

These calls are likely to produce an intrastate cost-revenue mismatch, particularly if the VoIP provider uses its line heavily. Most states follow the practice of "flat rating" all local calls. In those states, the only charge is the local monthly business line rate, and the VoIP call will fail to generate any incremental local exchange revenue. Revenue requirements arising from incremental costs therefore could be shifted to other intrastate service users, who could be required to subsidize the interstate VoIP service.

An interstate cost-revenue mismatch is also likely. There is no interstate revenue in this scenario. Interstate costs will be shifted to other interstate service users, who

²² Concentrator equipment and switch line cards typically are designed to allow only a small fraction of lines to be in use at the same time.

²³ ARMIS figures for 2003 show that for all Bell Operating Companies, Central Office Equipment was separated approximately 71 percent to state and 29 percent to interstate.

might also be required to subsidize the VoIP traffic. The burden on those other customers will increase as VoIP displaces traditional interstate access revenues.

In this scenario, the VoIP call makes at most a limited contribution to the joint and common costs of providing loops, and circuit, switching and trunking equipment. This could violate 47 U.S.C. § 254(k).²⁴

In summary, the interstate/local VoIP call leaves both jurisdictions with incremental costs that cannot be recovered and might fail to collect a sufficient contribution toward the costs of joint and common equipment. Because this hypothetical VoIP call has been postulated as an interstate call, preemption would not alter this analysis. The act of preemption, however, would probably have the practical effect of ratifying the status quo.

b) *The Intrastate Toll Call Terminated as Local*

A VoIP carrier can also transport a call between customers in different calling areas of the same state, but terminate the call from a business line or Centrex line. Once again, the local exchange carrier records only a local call from the VoIP carrier's business line to the terminating end user.

This scenario is similar to that described above with regard both to an interstate cost-revenue mismatch²⁵ and to a limited contribution to the joint and common costs of joint and common equipment.

²⁴ Section 254(k) requires that "services included in the definition of universal service [shall] bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."

²⁵ In this case the problem is not made worse by any loss of interstate access revenue.

The intrastate cost-revenue mismatch is worse in this scenario, however. The same incremental revenue is received as for an interstate call, and the same incremental costs are imposed, but there is an additional loss of intrastate toll access revenue. The resulting mismatch could affect local rates, particularly in rural study areas.

In summary, the intrastate/local VoIP call leaves both jurisdictions with incremental costs that cannot be recovered, a problem that can be particularly serious for the state jurisdiction. In addition, there might be an insufficient contribution toward the costs of joint and common equipment.

Preemption would exacerbate this situation because it would remove from the state the ability to collect access revenue for an intrastate toll call and because it might prevent the state jurisdiction from collecting the incremental state costs created by the VoIP call.

c) State Authority Over Local Calls

Under present law, states could theoretically address most of these issues through changing their rate designs for local traffic. A state might, for example, prohibit business line users from using their lines for such purposes in the first place, although that would be difficult to enforce. If the Commission were to preempt all VoIP traffic, however, states might no longer feel able to address the cost/revenue imbalance or the need to properly allocate joint and common costs as required under the second sentence of section 254(k). Preemption of VoIP therefore might remove from the states the ability to design intrastate rates and to allocate costs among the users of intrastate services.

VoIP growth could easily magnify this harm. VoIP already has an economic advantage in terminating traffic, and a preemption decision could clear away the risk that

states might eliminate this advantage. This could accelerate network conversion to IP format. Such a result may not be bad in itself, but it leads to a secondary result, the magnification of any cost/revenue imbalances and mandated subsidies. As noted above, full VoIP conversion could also eliminate any need for intrastate rates. If the Commission is considering preempting the states, it should anticipate the long-term effects of its decision, including how costs will be recovered in a world in which VoIP predominates.

3. Post-Preemption Cost Mismatches

The preceding discussion assumes that current VoIP termination arrangements will continue unaltered. Earlier this year, the Commission indicated that those arrangements might change. The Commission members stated their belief that “any service provider that sends traffic to the PSTN should be subject to similar compensation obligations, irrespective of whether the traffic originates on the PSTN, on an IP network, or on a cable network.”²⁶ The Commission has not indicated how this compensation would be established. We assume for purposes of these comments that the Commission contemplates a system, like toll access or reciprocal compensation, in which a VoIP provider seeking to terminate its traffic through a switched carrier must identify its termination request and compensate the terminating provider at some prescribed rate.

The jurisdiction assigned to any such LEC revenue is an important separations issue. As we noted above, current separations rules currently assign at least two-thirds of the incremental costs of providing VoIP termination on local lines to the state

²⁶ *Matter of IP Enabled Services*, WC Docket No. 04-36, FCC 04-38, released Mar. 10, 2004, para. 61.

jurisdiction. To maintain basic fairness in the separations system, revenue from these services should be assigned in a like manner. It would be of serious concern to the State Members if revenue generated by VoIP service fails to contribute in any way to intrastate costs that it creates. Moreover, assignment of those revenues solely to the interstate jurisdiction would violate the requirements of section 254(k) of the Act.²⁷ These problems might, at minimum, prevent us from supporting extension of the existing freeze and might justify immediate termination of the freeze and prescription of new measurement techniques or allocation percentages.

H. DSL

A decision declaring VoIP to be interstate would exacerbate a set of existing problems relating to the separation of DSL costs. Since 1998, the Commission has allowed carriers to treat DSL revenues as interstate revenues, but it made no adjustment to separations and did not refer the question to this Joint Board. In 2000 this Joint Board recommended continued study of the DSL issue,²⁸ but no such continued study has occurred.

We remain concerned about the effect of DSL on basic rates. We believe that in order to deploy DSL, many carriers are incurring intrastate costs for line conditioning and for remote fiber platforms. There is no matching intrastate revenue. Once again, this

²⁷ Section 254(k) requires that “services included in the definition of universal service [shall] bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.”

²⁸ *Freeze RD*, para. 27.

raises questions about the basic fairness of cost separations and whether DSL services are contributing sufficiently to the joint and common costs of universal service.

Two additional developments will make this problem worse. First, the DSL problem has become more acute since carriers have begun to offer DSL to customers who do not subscribe to voice services (“Solo DSL”). With traditional DSL, while all revenue is interstate, 75 percent of common line cost is assigned to the state. At least in this circumstance, the cost can be recovered through the sale of the loop for voice service. With Solo DSL, however, that revenue source disappears. This problem could be corrected by directly assigning the loop to interstate, but we are not certain that carriers selling solo DSL are actually taking this step.

Second, if VoIP displaces a larger portion of toll and local traffic, the financial imbalances described above will be magnified. The worst case would be VoIP traffic that rides on a solo DSL platform. If all such traffic and services are declared interstate, the intrastate jurisdiction would have no possible revenue sources to cover the 75 percent of loop cost assigned to the states.

I. Recommendations

If the Commission does declare IP-enabled services to be interstate, the undersigned State Members recommend several steps to the Commission.

1. Rate Design Discretion

The Commission should expressly state that its preemption does not impair state discretion over rate design for all local exchange services, including VoIP calls terminating over business lines. Business line tariffs have been designed on the

assumption that only retail customers would use them. They were not designed to allow telecommunications carriers to use them as terminating trunks. Yet VoIP providers are doing exactly this. If the Commission preempts state jurisdiction over VoIP, and if it continues to rely on state business lines to terminate those VoIP calls, the Commission should at the very least expressly preserve state discretion to design local exchange rates for those business or Centrex lines in a way that recovers costs from cost-causers.²⁹

2. Separations Factor Changes

If the Commission preempts the states on VoIP, it should issue a Notice of Proposed Rulemaking proposing several changes to separations rules. We recommend that the NPRM solicit comment on the following changes:

- Changing the fixed allocator for loop plant found in 47 C.F.R. § 36.154(c). Until reliable studies can be produced showing the extent of interstate Internet and VoIP traffic that is being recorded as local traffic, we tentatively conclude that, following preemption of IP-enabled services, 50 percent of subscriber common line investment should be assigned to the interstate jurisdiction. Where a carrier has completely converted its network to IP format, 100 percent of its investment should be assigned to interstate.
- Adjustment of frozen usage-sensitive factors. As discussed above, allocating costs properly for VoIP services is difficult because the jurisdictional nature of the traffic cannot be ascertained by the switched carrier that is asked to terminate that

²⁹ For example, a state might choose to impose local measure service charges on some or all business line traffic, either originating or terminating. Or, a state might develop subclasses of business lines, based upon characteristic usage patterns.

traffic. Therefore, it will be difficult to measure, or even estimate, the appropriate adjustments to interstate usage factors. Until reliable studies can be produced showing the extent of interstate-local traffic, we tentatively conclude that, following preemption, frozen separations factors should be changed by transferring 33 percent of each company's current local DEM to the interstate jurisdiction and recalculating separations factors accordingly. Where a carrier has completely converted its network to IP format, 100 percent of its investment should be assigned to interstate.

- Adjustment of universal service parameters. A multitude of universal service programs provide support to high-cost carriers. Any adjustment to separations factors could require parallel adjustments to the assumptions and parameters used in these calculations. An NPRM should inquire whether any changes are needed to the rules under which such support is calculated.

3. DSL

We tentatively conclude that when a carrier provides Solo DSL, the carrier should identify that loop as Cable and Wire Facility, Subcategory 1.2, (Interstate private lines and interstate WATS lines). Such facilities are directly assigned to interstate. However, we recognize that there may be some ambiguity in the rules, and that they may need to be clarified.

We recommend that the separations NPRM described above should also solicit comment on the following changes relating to DSL:

- Changing 47 C.F.R. § 36.154(a) to clarify that Solo DSL Exchange Line C&WF is Cable and Wire Facility, Subcategory 1.2, (Interstate private lines and interstate WATS lines) and should be directly assigned to interstate.
- Changing the fixed allocator in 47 C.F.R. § 36.154(c) for loops providing both DSL and voice. Until reliable studies can be produced showing the extent of interstate-local traffic, we tentatively conclude that, the 25 percent fixed allocator should be changed to allocate 66.7 percent of subscriber common line investment to the interstate jurisdiction.

4. Freeze

Fourth, we further recommend the NPRM include several questions regarding the end of the freeze. We are separately undertaking a data collection effort regarding the freeze, its effects, and the likely effects of ending the freeze. We want to emphasize here that the importance of that data collection would only be increased by a Commission decision altering existing jurisdictional rules regarding VoIP. Asking for comment on those same questions would increase our understanding of the effects of VoIP on traffic,

the separations factors, and it would improve our understanding of the options surrounding the end of the freeze.

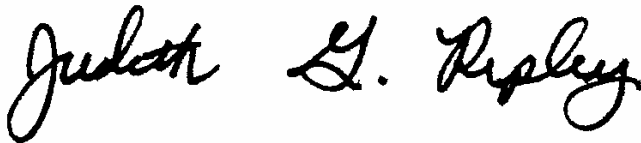
Respectfully Submitted,
State Members of Separations Joint Board



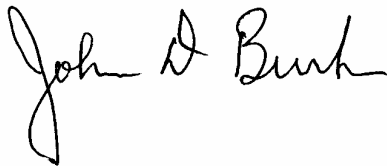
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Diane Munns
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Judith Ripley
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John Burke
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October 26, 2004